AUG 8 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 316

JACOB MEHRLUST,

Petitioner,

—against—

JOSEPH T. HIGGINS, individually and as Collector of Internal Revenue for the Third District of New York,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

ANDREW B. TRUDGIAN,
Counsel for Petitioner.

DAVID J. LEVY,
Of Counsel.

August, 1940.

THE COURT PRESS, N. Y. C.

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Respondent.

Petition for Writ of Certiorari to the Circuit Court of Appeals for the Second Circuit.

Petitioner respectfully prays that a writ of certiorari issue to review a judgment of the Circuit Court of Appeals for the Second Circuit reversing a judgment of the District Court for the Southern District of New York in favor of the plaintiff in an action to recover a refund of Federal Manufacturers' Excise tax assessed under Section 605 of the Revenue Act of 1932.

OPINIONS BELOW.

The opinion of the District Court (R. 36) is reported in 30 F. Supp. 166. The opinion of the Circuit Court of Appeals (R. 47) has not yet been reported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on July 3, 1940 (R. 51). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

Whether petitioner was subject to manufacturer's excise tax, under Section 605 of the Revenue Act of 1932, on sales of jewelry after the effective date of the tax by a corporation of which he was the sole stockholder and to which he had sold such jewelry before such effective date?

Statutes and Regulations Involved.

The pertinent statutes and regulations involved are set forth in the Appendix, *infra*, pages 19 to 21.

Statement.

Section 605 of the Revenue Act of 1932, passed June 6, 1932, imposed an excise tax of 10% on sales of jewelry during the period June 21, 1932, to July 1, 1934, by a manufacturer, producer or importer. The law was not effective until fifteen days after its passage giving manufacturers an opportunity during this period of selling without tax as much of their manufactured stock as their selling facilities enabled them to dispose of. Under Section 619 of the Act, the tax was to apply to sales made after its effective date even though not arm's length transactions. There was no provision with respect to such transactions before such effective date.

Petitioner, a manufacturer of jewelry long prior to June 6, 1932, organized, on June 17, 1932, a corporation, J. Mehrlust, Inc., and in consideration of $2,500.00 in cash paid into its treasury, acquired 500 of its authorized 1,000 shares of no par value stock thus becoming its sole stockholder. On June 18th, he also sold to it, for $628,243.00, his stock of completely manufactured jewelry receiving the company's demand note for $626,243.00 and $2,000.00 in cash.

On June 18, 1932, the petitioner owed the banks some $235,000.00 in notes and had been repeatedly questioned by the banks as to the status of his affairs. The company paid in part its debt to him by giving to these banks its notes, endorsed by him, in exchange for his notes, the bank debts thus becoming funded and protected from the risks of his individual business. By January 1, 1939, the company's note to him had been reduced to $84,000.00, in part by it assuming his obligations to the banks and in part by other payments.

After the effective date of the Act, the company proceeded to sell to the general trade the manufactured jewelry it had so acquired, and petitioner continued to manufacture and sell to the general trade, as before, but made no further sales to the company. The company maintained its own separate books and records, and bank account, and filed its own separate tax returns to the Federal and State authorities.

Petitioner paid the excise tax on all sales of jewelry manufactured and sold by him individually after an effective date of the Act, but the corporation did not pay tax on its sales on the ground that it was not a manufacturer, producer or importer of the articles sold. The Commissioner, however, disregarded the sale of June 18, 1932, and taxed petitioner as though he had continued to sell the jewelry. Petitioner paid the taxes so levied

and was not reimbursed therefor. Thereafter he filed a claim for refund of the amount so paid and upon its rejection sued the Collector of Internal Revenue of the Third District of New York in the United States District Court, Southern District of New York. The case was tried to a judge upon an agreed state of facts, and judgment was entered for petitioner. The Circuit Court of Appeals has reversed this judgment.

Specification of Errors.

The Circuit Court of Appeals erred:

(1) In disregarding the intent of the Revenue Act of 1932 that no tax should apply on the articles of jewelry sold by petitioner to J. Mehrlust, Inc., before the effective date of the Act.

(2) In holding that the Treasury Department may, in all cases, if it sees fit, disregard a corporation for the purpose of taxing its stockholder.

(3) In disregarding the large outside interests in the corporation, represented by the banks, and considering it one which, because there was a single stockholder, might be disregarded by the Treasury Department.

Reasons for Granting the Writ.

1. The decision of the District Court was reversed because the Circuit Court of Appeals interpreted the income tax case of *Higgins* v. *Smith*, 308 U. S. 473, as establishing the rule that the Treasury Department may, in all cases, if it sees fit, disregard a corporation and tax its stockholder. It is the opinion of the Circuit Court

of Appeals that this rule applies regardless of the fact that the corporation has kept all necessary records and carried on its own business like any other merchant; and regardless of the fact that the corporate property is subject to its own creditors alone (R. 48, 49).

The District Court found that petitioner had divorced himself from all title to the merchandise (R. 40); that there had been a bona fide sale between two separate legal entities: the petitioner and the corporation (R. 40), and that the corporation exercised power and control over the merchandise transferred and was not a mere sales agency for the petitioner (R. 40). It also found, in connection with the fact that sales by petitioner before the effective date of the tax would escape the tax, that it was not compelled "to require an over-the-counter sale to defeat" the tax (R. 39). The Circuit Court of Appeals did not reverse the District Court on these findings but, as stated, on the basis of the general rule of law which it understood to have been established in *Higgins* v. *Smith*, *supra*.

It is submitted that a reading of the opinion of the court in *Higgins* v. *Smith*, *supra*, does not reveal that there is a general rule enunciated in that case, as found by the Circuit Court of Appeals, but that the Court merely referred to the right of the government to disregard a fiction. As a matter of fact, that case contains a warning against drawing conclusions as to the establishment of general rules in that when the government in that case urged that *Gregory* v. *Helvering*, 293 U. S. 465, was authority "for a realistic approach to tax situations" the Court retorted that "as so broad and unchallenged a principle furnishes only a general direction, it is of little value in the solution of tax problems".

If it is true that a general rule exists permitting the Treasury Department, as it sees fit, to ignore a jural

entity, the corporation, and reach the stockholder, it is important that the existence of that rule be more broadly enunciated. Moreover, the instant case is peculiarly adapted for such enunciation. Under Section 619 of the Revenue Act of 1932 there was to be the immediate recognition and taxation of sales between such interests as a stockholder and his company. This was because the tax under Section 605 was only to apply for a limited period and Congress wanted it to apply at once to such sales because, if it did not, the merchandise bought might not be resold before the tax went off and the government would lose revenue. Therefore, there could be no doubt as to the wide application of the rule if it were held in the instant case that the Treasury Department could ignore the sale by petitioner to the corporation before the effective date of the Act when, if such sale had occurred after such effective date, it would have been recognized and taxed.

2. It appears that there exists a conflict in the Circuit Courts of Appeal with reference to the principles enunciated in *Higgins* v. *Smith*, 303 U. S. 473, *supra*. In the instant case of *Mehrlust* v. *Higgins* the Circuit Court of Appeals for the Second Circuit regardless of the fact that the company was fully organized and doing business like any other merchant, and had property subject to its own creditors, alone, and without questioning the findings of the District Court as to the bona fides of the sale by the petitioner to the company, and the separateness of the stockholder and corporation, held that the stockholder was taxable under *Higgins* v. *Smith*, *supra*. On the other hand, as appears from the decision of the Circuit Court of Appeals of the Tenth Circuit in *Continental Oil Company* v. *Jones*, decided June 26, 1940, the United States Circuit Court of Appeals for the Tenth Circuit holds that whether

the separateness of corporate identity should be maintained or disregarded in a case involving tax problems depends upon the facts and circumstances in the particular case. There accordingly is a wide divergence between the views of these circuits and it is of the utmost importance that the true rule be made evident.

Conclusion.

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

ANDREW B. TRUDGIAN,
Counsel for Petitioner.

David J. Levy,
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August, 1940.